October 21, 2020

The Honorable Jay Clayton
Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair Clayton:

We write to oppose the Securities and Exchange Commission's (SEC or Commission) rule proposal: Reporting Threshold for Institutional Investment Managers, Release No. 34-89290, File No. S7-08-20 (the Proposal).[1] The Proposal would radically increase the reporting threshold for Form 13F reports by institutional investment managers, upending the existing reporting framework and eliminating a significant source of transparency in the U.S. stock market. Instead, we urge the SEC to withdraw the Proposal and consider Form 13F reforms that would increase transparency and utility.

To start, the Commission relies on several flawed justifications for the Proposal. First, the Proposal disregards the statutory language in section 13(f) of the Securities Exchange Act of 1934 and selectively looks to legislative history and other sources to rationalize the increased reporting threshold, which does not exist in the plain text of section 13(f). Second, the Proposal also exaggerates expected costs savings and ignores the quality of the information that would be lost. Overall, the Proposal would undermine the market transparency that Congress intended, impair small and medium-sized companies' understanding of their investor base, and empower activist investors. Moreover, the Proposal fails to even attempt to address the most obvious reform to Form 13F filings—reducing the filing delay from the 45 days established in 1978.

Unauthorized Administrative Overreach

As institutional investors increased their ownership of U.S. stocks, Congress in 1968 sought to improve the nature and quality of information about the securities market. Specifically, Congress charged the Commission to conduct a study and investigation of the purchase, sale, and holding of securities by institutional investors of all types.[2] Accordingly, in the letter accompanying its 1971 Institutional Investor Study Report, the Commission explained that it "believes that gaps in information about the purchase, sale and holdings of securities by major classes of institutional

[1] Reporting Threshold for Institutional Investment Managers, Release No. 34-89290, File No. S7-08-20, 85 FR 46016, RIN 3235-AM65 (proposed July 10, 2020) [hereinafter Proposal], https://www.federalregister.gov/documents/2020/07/31/2020-15322/reporting-threshold-for-institutional-investment-managers.
[2] Section 19(e) of the Securities Exchange Act of 1934 (Pub. L. 90-438).

investors should be eliminated,"[3] and recommended that the Securities Exchange Act of 1934, "be amended to provide the Commission general authority to require reports and disclosures of such holdings and transactions from all types of institutional investors."[4]

Heeding those recommendations, Congress passed Section 13(f) of the Securities Exchange Act as part of the Securities Act Amendments of 1975 to require institutional investment managers "having . . . at least $100,000,000 or such lesser amount (but in no case less than $10,000,000) as the Commission, by rule, may determine" to report the equity securities that they control.[5] The statutory requirement sought two objectives: (i) to improve the availability of factual data to evaluate the influence, impact, and public policy implications of institutional investment managers on the securities markets, and (ii) to establish a uniform reporting standard and centralized database of institutional holdings that is gathered, processed, and disseminated by the Commission.[6] In 1978, the Commission, in turn, adopted rule 13f-1 and Form 13F, requiring every institutional investment manager that exercises investment discretion over equity securities with a market value of at least $100,000,000 on the last trading day of any month to file a report on Form 13F within 45 days after the last day of each calendar quarter.[7]

The Commission betrays the legislative language and selectively reads and misconstrues the legislative history to conclude that it has the ability to increase the reporting threshold to 35-times the existing level. SEC Commissioner Allison Herren Lee criticized this flaw in the Proposal this way "[t]he text is clear: Congress set a statutory reporting threshold at $100 million, and the Commission has the authority to lower it. The proposing release does not wrestle with this language at all, and asserts uncritically that Section 13(f)(1) provides us with the relevant authority. Congress appears to have said otherwise, setting specific limits on the Commission's authority in that respect."[8] In short, the Proposal's purported basis for raising the reporting threshold is simply wrong. Indeed, we remind the Commission that legislative history does not take precedence over clear statutory text, and it is the role of Congress to write laws.

Despite the plain reading of the statutory text that grants the Commission the authority to lower the $100 million threshold, the Proposal cites the one passage in the Senate Report accompanying the Securities Act Amendments of 1975 that states the Commission would "have the authority to raise or lower"[9] the threshold. The Commission conveniently declines to quote two other parts of the Senate Report that refer to the SEC's ability only to lower the threshold. In the discussion of the scope and nature of section 13(f), the Senate Report states, "the bill would

[3] Institutional Investor Study Report of the Securities and Exchange Commission, Summary Volume, 92d Cong. House Document, 92-64, Part 8, Mar. 10, 1971, at x-xi.
[4] *Id*.
[5] Pub. L. 94-29.
[6] Filing and Reporting Requirements Relating to Institutional Investment Managers, Release No. 34-14852 (June 15, 1978).
[7] *Id*.
[8] Statement on the Proposal to Substantially Reduce 13F Reporting, Commissioner Allison Herren Lee, July 10 2020, https://www.sec.gov/news/public-statement/lee-13f-reporting-2020-07-10.
[9] Report to Accompany S.249, Securities Act Amendments of 1975, Sen. Rep. No. 94-75, at 107, 94th Cong. 1975.

give the SEC rule-making authority *to lower* the securities holdings cut-off test if it found that lower test requiring more institutional managers to report was in the public interest, for the protection of investors, or necessary or appropriate to maintain fair and orderly markets."[10] The report further clarifies that, "[i]f the SEC should determine that the public interest would be better served by bringing into the program smaller institutional investment managers, it has rulemaking authority to reduce the securities holding cut-off figure to $10 million."[11] In both instances, the Senate Report does not suggest the SEC has the ability to determine a threshold beyond $100 million, and even if the Senate Report were to do so, report language cannot rewrite or go beyond the plain text of a duly enacted law.

Furthermore, the original 1977 proposing release for rule 13f-1 and Form 13F further evidences the Commission's statutory ability only to lower, rather than increase, the $100 million threshold. In that proposal, the Commission asks "[s]hould institutional investment managers exercising investment discretion over accounts holding less than $100 million of Section 13(d)(1) equity securities included on the Commission's list be required to file Form 13F? What would be an appropriate amount?"[12] The proposing release shows that at inception of rule 13f-1, the Commission did not even consider the possibility of a higher threshold.

To support the higher threshold, the Commission also selectively points to the Office of the Inspector General's 2010 Review of the SEC's Section 13(f) Reporting Requirements (OIG Review). In the Proposal, the Commission cites Recommendation 11 of the OIG Review, which advised that the "Division of Investment Management, in consultation with the Chairman's Office, should request that the Division of Risk, Strategy, and Financial Innovation update its analysis of the impact of increasing the reporting threshold of $100 million."[13]

The Commission skips over Recommendation 10, which advised several SEC offices to collectively "determine whether legislative changes to Section 13(f) of the Securities Exchange Act of 1934 should be sought, specifically with respect to . . . increasing the Section 13(f) reporting threshold".[14] The OIG Review includes the staffs' responses to the Recommendation 10, where the Division of Investment Management states, "[w]e concur with the recommendation. . . . We also concur with the RiskFin comments as they relate to this recommendation. In particular, we emphasize that consideration of significant changes to Form 13F should be part of a coordinated review of the overall SEC system for disclosing ownership and transactions in the securities of public companies, rather than in isolation."[15] Accordingly, the OIG Review fully contemplated the need for Congress to increase the reporting threshold and did not consider it within the SEC's authority, and the SEC staff agreed.

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[10] *Id*. at 85 (emphasis added).
[11] *Id*. at 86.
[12] Reporting by Institutional Investment Managers of Information With Respect to Accounts over Which Investment Discretion is Exercised, Release No. 34-13396, File 57-687 (Mar. 18, 1977)
[13] Office of the Inspector General, *Review of the SEC's 13(f) Reporting Requirements* at 37 (Sept. 27, 2010) [hereinafter OIG Review], https://www.sec.gov/files/480.pdf.
[14] *Id*.
[15] *Id*. Appendix V at 42.

To be clear, Congress did not provide the Commission with the statutory authorities to raise the 13F reporting threshold beyond $100 million, and no amount of legislative history can be used to contradict or defy the plain text of the law as written. The Commission derives its authorities, powers, and funds from Congress; not the other way around.

Flawed Analysis

Even if Congress had provided the requisite statutory authority, which it did not, the Commission's assertion that rule 13f-1 should be amended to increase the reporting threshold to $3.5 billion to reflect the same proportion of the overall value of the U.S. stock market that $100 million represented in 1975 is illogical and fails to consider the diminished quality of the information that would be reported at the higher threshold. Specifically, the Proposal observes that the 35-fold increase would retain 90% of the dollar value of the securities currently reported without considering the harm from excluding reports from nearly 90% of the investment managers that currently file a Form 13F.[16] The claim that retaining 90% of the dollar value of existing Form 13F reports is sufficient relies on a metric not found in the statutory text or explained as an objective in the legislative record within the bounds of the statute.

The Commission also discusses the costs associated with Form 13F, but its suggestion that those costs justify such a purge of critical market information is hard for any reasonable person to believe. The Proposal provides a range of direct costs to prepare filings and suggests there are indirect costs to some institutional investment managers due to public disclosure of their stock holdings. Yet, the Commission undermines its own argument when it states the "academic literature provides *partial evidence* about the harm caused by the action of third parties"[17] and fails to consider the impact of the reduction in quality of available information about public share ownership on public companies, market participants, or the Commission itself.

The Commission also distorts the cost analysis by introducing a new estimate for preparation of Form 13F that inflates the estimated costs on filers. Commissioner Lee's public statement questions the new methodology and assumptions[18] and points out the Form 13F cost estimates the SEC used in 2018 show a fraction of the cost savings in the Proposal. The Proposal states, "direct compliance costs could range from $15,000 to $30,000 annually per manager"[19] that would no longer file, but Commissioner Lee explains, "[h]ad the proposal stuck with the prior

[16] Proposal at 17-18.
[17] Proposal at 19 (emphasis added).
[18] Commissioner Lee notes, "The proposal abruptly takes a new approach to the PRA estimate, increasing it to roughly $113.6 million. The nearly fourfold increase in estimated burden is driven in large part by new assumptions about the types of professionals involved in the preparation of Form 13F filings. Specifically, the Commission now assumes that each filing requires equal time from a compliance attorney, a senior programmer, and a compliance clerk, resulting in a hefty increase in the hourly cost estimate. This new estimate, in addition to being impossible to reconcile with past Commission estimates, is difficult to square with the substantive requirements of Form 13F." Statement on the Proposal to Substantially Reduce 13F Reporting, Commissioner Allison Herren Lee, July 10 2020, https://www.sec.gov/news/public-statement/lee-13f-reporting-2020-07-10.
[19] Proposal at 18.

[Paperwork Reduction Act] estimate, the grand total cost savings to weigh against the reduced transparency would have amounted to roughly $4,000-$5,000 per institutional investment manager." [20]

Additionally, the Commission's new methodology appears questionable based on the comment letter submitted by Cleveland, Ohio, based Advisor Consultant Network (ACN), which identifies itself as the largest service provider of Form 13F reporting services. ACN's letter explains that the average Form 13F filer does not need the personnel assumed in the proposal, relying instead on investment tracking software and data platforms.[21]

While proposing an unprecedented 3,400% increase in the Form 13F reporting threshold, the Commission ignores several ways to improve transparency and provide more information to investors and market participants. For example, the Commission fails to acknowledge the required rulemaking under Section 929X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Wall Street Reform Act), which directed the Commission to require Form 13F filers to report short sales each month. In addition, the Commission does not even consider shortening the 45-day delay in Form 13F's reporting deadline,[22] which has stood since 1978. Given the improvements in technology and the SEC's own enhancements in its electronic filing system, the "undue burden" the SEC claimed 42 years ago when adopting the 45-day delay[23] instead of the 30 days it originally proposed[24] seems outdated. By failing to discuss either of these measures to increase transparency, the Commission makes plain that the only updates it seeks are contrary to the plain reading of section 13(f) and to the Commission's mission.

The Commission also appears indifferent to how the Proposal would adversely affect small and mid-sized companies' ability to understand and engage with their shareholder base. Form 13F filings provide crucial ownership information to company managers, and by eliminating reporting by nearly 90% of institutional investment managers, the SEC would deny companies access to information necessary for shareholder engagement. That is why in September alone, well over 50 publicly-listed companies, including household names like Ford,[25] CVS Health,[26]

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[20] Statement on the Proposal to Substantially Reduce 13F Reporting, Commissioner Allison Herren Lee, July 10 2020, https://www.sec.gov/news/public-statement/lee-13f-reporting-2020-07-10.

[21] Advisor Consultant Networks, Inc., Comment Letter on Reporting Threshold for Institutional Investment Managers (Sept. 10, 2020), https://www.sec.gov/comments/s7-08-20/s70820-7757531-223233.pdf.

[22] Petition for Rulemaking Under Section 13(f) of the Securities Exchange Act of 1934 (Feb. 1, 2013) https://www.sec.gov/rules/petitions/2013/petn4-659.pdf.

[23] Filing and Reporting Requirements Relating to Institutional Investment Managers, Rel. No. 34-14852, File No. S7-687, June 15, 1978.

[24] Reporting by Institutional Investment Managers of Information with Respect to Accounts Over Which Investment Discretion is Exercised, Release No. 34-13396, File No. 57-687, Mar. 22, 1977.

[25] Ford Motor Company, Comment Letter on Reporting Threshold for Institutional Investment Managers (Sept. 18, 2020), https://www.sec.gov/comments/s7-08-20/s70820-7794103-223556.pdf.

[26] CVS Health Corporation, Comment Letter on Reporting Threshold for Institutional Investment Managers (Sept. 29, 2020) https://www.sec.gov/comments/s7-08-20/s70820-7860052-223910.pdf.

Marriott,[27] and Stanley Black and Decker,[28] filed unique comment letters opposing the increase of the Form 13F reporting threshold. Hundreds more signed on to opposition letters from Nasdaq[29] and the New York Stock Exchange.[30] All of those companies delivered a clear message: the Proposal would take away the critical transparency provided by Form 13F filings, reduce the ability for shareholder engagement, and deprive them of timely information when activist hedge funds take positions in their shares.

This harm would disproportionately fall on small and micro capitalization companies. According to analysis performed by market analytics firm IHS Markit, small capitalization firms would lose insight into ownership of 14.4% of their shares, and micro capitalization firms would lose 17.1%.[31] Even larger firms would lose sizeable visibility into their share ownership.[32] IHS Markit further considered the impact by type of investor, finding that while, on average, 55% of the investors on a company's shareholder list would stop filing a Form 13F, the portion of hedge funds on a company's shareholder list that would stop filing rises to 69%. Again, this is another clear indication that the Commission disregarded the negative effect the Proposal would have on transparency.[33]

This negative effect surely includes real costs to companies and their employees who will be more susceptible to the covert actions of activist hedge funds. Because Form 13F does not require disclosure of over-the-counter options even when they are economically equivalent to owning share in a company, activist funds already abuse outdated SEC disclosure rules to amass covert stakes in public companies. The OIG Review explained the problem created by this information gap, "the public cannot obtain a complete picture of all significant investment activities of institutional investment managers."[34] Under the Proposal, it will be more difficult and costly for companies to recognize and respond to these investor groups. It should not be surprising that the agenda of an activist fund that would engage in such stealth activity is to

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[27] Marriott International, Inc., Comment Letter on Reporting Threshold for Institutional Investment Managers (Sept. 24, 2020), https://www.sec.gov/comments/s7-08-20/s70820-7825722-223740.pdf

[28] Stanley Black and Decker, Comment Letter on Reporting Threshold for Institutional Investment Managers (Sept. 16, 2020), https://www.sec.gov/comments/s7-08-20/s70820-7783671-223507.pdf.

[29] Nasdaq, Inc., et al., Comment Letter on Reporting Threshold for Institutional Investment Managers (Sept. 22, 2020), https://www.sec.gov/comments/s7-08-20/s70820-7807388-223697.pdf.

[30] NYSE, Intercontinental Exchange, et al., Comment Letter on Reporting Threshold for Institutional Investment Managers (Sept. 21, 2020), https://www.sec.gov/comments/s7-08-20/s70820-7797941-223589.pdf.

[31] SEC's 13F Proposal – Issuer and Investor Analysis, Aug. 7, 2020, https://ihsmarkit.com/research-analysis/secs-13f-proposal--issuer-and-investor-analysis.html.

[32] Ranging between 9.4% for midsize companies and 4.4% for the very largest companies.

[33] IHS Markit's analysis of ownership in 70 companies in the consumer services sector found, on average, 15 percent of the top 100 shareholder lists would no longer be required to file a Form 13F under the new proposal and nearly a quarter (23 percent) of investors in companies with a market value of less than $1 billion would not be required to file a Form 13F. SEC Proposes Boosting the 13F Reporting Threshold - Potential Impact, July 14, 2020, https://www.linkedin.com/pulse/sec-proposes-boosting-13f-reporting-threshold-potential-yokum/.

[34] OIG Review at 25-26.

extract value, which frequently imposes social costs on workers and communities and results in unsustainable debt burdens for targeted companies.[35]

Finally, we are unable to view the SEC's proposal in isolation. On September 21, the Federal Trade Commission (FTC) proposed changes to its premerger notification rules under the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) that would expand filing exemptions and allow activist investors to acquire up to 10% of a company's voting securities without an HSR Act filing so long as that investor does not have a significant investment in a competitor of the target company.[36] Taken together, the Proposal and the FTC's proposed amendments would permit activist investors to acquire strategic and significant stakes in companies unbeknownst to the marketplace or the companies. This concern becomes particularly acute amid predictions for increasing activist investor activity in 2021 given the difficult market conditions caused by the coronavirus pandemic.[37] Companies focused on surviving the economic slowdown could be forced to navigate a regulatory landscape that leaves them even more vulnerable and more likely unaware of unwanted activist interest.

In conclusion, the Proposal would unnecessarily and unjustifiably decrease transparency and reduce access – for the public and the SEC – to critical information about the U.S. stock market. The SEC should withdraw it and consider reforms that provide investors, the SEC, and other regulators with more information, not less.

Sincerely,

Sherrod Brown
U.S. Senator

Tammy Baldwin
U.S. Senator

Jack Reed
U.S. Senator

Chris Van Hollen
U.S. Senator

[35] Mark DesJardine and Durand Rodolphe, Disentangling the effects of hedge fund activism on firm financial and social performance (Jan. 3, 2020), https://onlinelibrary.wiley.com/doi/10.1002/smj.3126.
[36] Premerger Notification; Reporting and Waiver Period Requirements, RIN 3084-AB46, Sept. 21, 2020, https://www.ftc.gov/system/files/documents/federal_register_notices/2020/09/p110014hsractamendnprm09182020_0.pdf.
[37] Carleton English, Activist Investors Look to Resume Making Deals in 2021, *Barron's*, Oct. 5, 2020, https://www.barrons.com/articles/activist-investors-look-to-resume-making-deals-in-2021-51601664329; How boards can prepare for post-pandemic activism, Frank Aquila and Melissa Sawyer, Apr. 6, 2020, https://www.corporatesecretary.com/articles/boardroom/32040/how-boards-can-prepare-post-pandemic-activism.